Financial Management
List of Attachments

FM – A	Operating Funds Beginning Balance Research Report (Question 2)
FM – B	1997-98 Actual Budget Results City Council Report (Questions 2 and 11)
FM – C	1998-99 Summary Budget (Questions 8, 10, 11 and 15)
FM – D	Comprehensive Annual Financial Report (Question 8)
FM – E	Family Advocacy Center Site Location City Council Report (Questions 9 and 20)
FM – F	Contingency Status City Council Report (Question 9)
FM – G	1997-98 Funding Plan Research Report (Question 9)
FM – H	Five-Year General Fund Forecast City Council Report (Questions 10, 11 and 21)
FM – I	Preliminary 1999-2000 Annual Budget (Questions 10 and 11)
FM – J	1998-99 Detail Budget (Questions 10 and 17)
FM – K	Packet of Department Budget Instructions for Expenditures Process (Question 11)
FM – L	Assessed Value Forecast (Question 11)
FM – M	Packet of Department Budget Instruction for Revenue Process (Question 11)
FM – N	1999-2000 Initial General Fund Budget Status City Council Report (Question 11)
FM – O	Packet of Budget Ratings City Council Reports (Question 11)
FM – P	1999-2000 Trial Budget City Council Report (Question 11)
FM – Q	Newspaper Insert in English and Spanish (Question 11)
FM – R	Summary Investment Guidelines (Question 12)
FM – S	Schedule of Plan Assets, Employees Retirement Plan (Question 13)
FM – T	Retirement Board Investment Policy (Question 13)
FM – U	Retirement Plan Comprehensive Annual Financial Report (Question 13)
FM – V	Debt Position Report (Question 14)
FM – W	Monthly Financial Report (Question 18)
FM – X	Legislative Update City Council Report (Question 20)
FM – Y	Assessed Value and Debt Forecast Packet from Fiscal Capacity Committee (Question 21)
FM – Z	Liquidated Damages Schedule - Solid Waste Contract (Question 22)
FM – AA	Performance Standards Schedule - Solid Waste Contract (Question 22)
FM – AB	Public Private Competition Overview Booklet (Question 22)
FM – AC	Contract Performance Requirements Plans – Solid Waste Contract (Question 22)
FM – AD	Index of Administrative Regulations (Question 23)
FM – AE	City Manager’s Executive Report (Question 25)
FM – AF	Miscellaneous Comprehensive Annual Financial Reports (requested item)
FM – AG	Packet of Audits of Financial Management Systems (requested item)
FM – AH	Information on Financial Sites on City WebPage (requested item)

NOTE: A complete set of the 1998-99 published budget documents is enclosed. The process-oriented attachments (e.g., Trial Budget) are for the 1999-2000 process now underway. A complete set of the final 1999-2000 documents (Summary, Detail and Capital Improvement Program budget documents) will be provided upon request and following their completion.

Please answer the following questions about Financial Management in Phoenix.

1. **Please provide the following information concerning estimated and actual figures for revenues and expenditures. For each, please report figures *including* state and federal funds (top boxes in each row) and *excluding* state and federal funds (bottom boxes in each row), for the general fund and total of all operating funds fiscal years 1996 through 2000.**

Please note: These figures should include only current year revenues, and not any carry-forward balances. Also, the estimated column should reflect the last estimate that was made prior to the budget being adopted.

NOTE: Arizona law requires a General Fund budget be adopted in which all available resources shall equal expenditures. No General Fund balances can be budgeted in reserve. Instead, Arizona Statutes allow an amount for contingencies to be included. (Our General Fund contingency policy is reviewed in question 8.) As a result of this law, budgeted General Fund revenues are less than budgeted expenditures. However, no deficit is planned.

FUNDS	FY	ESTIMATED REVENUES	ESTIMATED EXPENDITURES	ACTUAL REVENUES	ACTUAL EXPENDITURES
General Fund*	1996	$ 590,874,000	$ 617,185,000	$ 606,972,000	$ 579,691,000
		$ 590,874,000	$ 617,185,000	$ 606,972,000	$ 579,691,000
Total of all Operating Funds	1996	$1,294,476,000	$1,393,902,000	$1,352,037,000	$1,330,520,000
		$1,084,066,000	$1,164,808,000	$1,188,453,000	$1,012,928,000
General Fund*	1997	$ 636,613,000	$ 660,429,000	$ 642,753,000	$ 621,704,000
		$ 636,613,000	$ 660,429,000	$ 642,753,000	$ 621,704,000
Total of all Operating Funds	1997	$1,513,470,000	$1,647,723,000	$1,432,976,000	$1,413,583,000
		$1,314,341,000	$1,401,271,000	$1,264,368,000	$1,248,756,000
General Fund*	1998	$ 640,616,000	$ 699,935,000	$ 697,677,000	$ 660,061,000
		$ 640,616,000	$ 699,935,000	$ 697,677,000	$ 660,061,000
Total of all Operating Funds	1998	$1,533,069,000	$1,610,592,000	$1,537,611,000	$1,503,996,000
		$1,306,771,000	$1.355.136,000	$1,365,845,000	$1,318,497,000
General Fund*	1999	$ 685,612,000	$ 738,669,000		
		$ 685,612,000	$ 738,669,000		
Total of all Operating Funds	1999	$1,651,946,000	$1,683,094,000		
		$1,424,438,000	$1,430,420,000		
General Fund*	2000	$ 746,246,000	$ 794,073,000		
		$ 746,246,000	$ 794,073,000		
Total of all Operating Funds	2000	$1,694,898,000	$1,697,994,000		
		$1,467,664,000	$1,473,397,000		

Source: Schedule I Summary Budgets; Table 1 & Financial Highlights, CAFR

*Estimates for periods prior to 1999-2000 are adjusted to reflect a change in the treatment of a portion of the state gas tax (AHUR). This funding source is now entirely classified as a special revenue and is reflected in the Total of all Operating Funds amounts. A portion of this funding had previously been budgeted in the General Fund.

Actuals were taken from the CAFR budgetary basis statements with two minor adjustments for differing treatments of Fiscal Impact Fees and Plan Six revenues. This was done to ensure that the estimates provided are consistent with the actuals provided.

1999-2000 estimates are reflective of the amounts included in the City Manager's Proposed Budget. This proposed budget was presented to the City Council on May 11, 1999. These estimates may change before adoption of the final 1999-2000 budget.

2. **Did estimated expenditures fall short of or exceed actual expenditures by more than 2% for any city agency last year? If so, please identify the agency (or agencies) and explain the reason for the difference between the estimated and actual expenditures.**

On a citywide basis, pre-audit actual expenditures were 1.8% under the estimated amount in 1997-98. Several departments had actual expenditures that fell outside the 2% variance range. This is consistent with management performance goals that favor under expenditures to over expenditures. (Pre-audit amounts are referred to because a standard report is prepared, as described in the following paragraphs, to evaluate such variances. Any significant changes in audited beginning balances, should they occur, are presented in a follow-up report.)

Attachment FM–A provides a Budget and Research Department Report titled "Pre-Audit Beginning Balances for 1998-99 Operating Funds." This report is prepared annually to identify and explain significant variances in resources and expenditures and will provide the detailed explanation requested in this question. A similar report is also prepared for capital funds.

Note: Many smaller departments or functions shown on Schedule III of the report have variances of more than 2%. Typically, these smaller entities can experience significant variances on a percentage basis because of an isolated staffing or line-item change.

In addition to the above referenced report, which is primarily prepared for management purposes, a report on actual to predicted results is also presented to the public and City Council. Attachment FM–B provides the City Council Report with information on the 1997-98 actual results including a discussion of the actual final assessed values and resulting property tax rate. (Assessed values are determined by the county and are not known before budget adoption.) This report is presented to the City Council as the first of a series of regular budget briefings scheduled with the City Council.

3. **On what dates were the budgets for the past three fiscal years signed into law?**

The final budget adoption dates for the last three fiscal year budget are shown below. These adoption dates were all consistent with the budget calendar established at the beginning of the budget process and are in compliance with Arizona law and the Phoenix City Charter.

1996-97, adopted June 26, 1996
1997-98, adopted June 25, 1997
1998-99, adopted June 24, 1998
1999-2000, planned adoption date is June 30, 1999

4. **Please provide the following information comparing total General Fund revenues, expenditures, and the unreserved, undedicated balance for the past four fiscal years *on a GAAP basis.***

REVENUES/ RESOURCES	EXPENDITURES/ USES	UNRESERVED, UNDEDICATED BALANCE	FY
$125,404,000/ $497,400,000	$406,223,000/ $482,717,000	$109,280,000	1995
$134,317,000/ $537,235,000	$448,700,000/ $536,624,000	$109,891,000	1996
$143,534,000 $565,874,000	$464,507,000/ $560,263,000	$115,502,000	1997
$150,953,000 $615,477,000	$505,086,000/ $607,257,000	$126,588,000	1998

Source: Exhibit B-2, CAFR

5. Were any of the following actions taken during either of the last two fiscal years in order to balance the general fund's budget? (For each, please indicate the dollar amount involved.)

ACTION:	FY1997	FY1998
Use of carry-forward balances in the general fund	Yes (1)	Yes (1)
Non-routine transfers from other funds	No	No
Sale of assets	No (2)	No (2)
Reduction of contributions to pension funds	No	No
Emergency funds	No	No
Delay of bills	No	No
Short-term borrowing	No	No
Other non-recurring resources	No (3)	No (3)

(1) – As explained earlier, Arizona law requires the adoption of a General Fund budget in which total resources equal total expenditures. Arizona law instead allows for a contingency fund as part of the annual adopted budget. Unused contingency amounts fall to the ending balance and provide a beginning balance resource for the following fiscal year. No carryover balances are specifically used to address financial difficulties.

(2) – Assets such as surplus equipment are routinely sold each year. The revenues from these sales are generally immaterial. Assets are not sold to address financial difficulties.

(3) – Other non-recurring resources, such as land sales and one-time grants, are planned for and included in the budget process when appropriate. However, non-recurring resources are not used to address financial difficulties.

6. Please explain the extent to which the resources identified in the previous question were used to finance ongoing expenditures versus one-time expenditures.

Revenues from sales of assets or other non-recurring sources such as one-time grants or awards do occur but are not used to finance ongoing expenditures.

7. If Phoenix ran a general fund surplus in the last completed fiscal year, how did it use these funds?

In compliance with Arizona law, General Fund budgeted expenditures must equal all available resources. Therefore, the 1997-98 General Fund balance was included as part of total General Fund resources. These funds are first allocated to establishing the following year's contingency fund.

8. Please provide the following information about contingency reserve funds (i.e., funds designed to ensure fiscal stability) and disaster funds (i.e., funds to pay for natural or man-made disasters) maintained by Phoenix:

TYPE OF CONTINGENCY RESERVE FUND:	End FY	MINIMUM BALANCE REQUIRED	MAXIMUM BALANCE ALLOWABLE	ACTUAL BALANCE MAINTAINED
Contingency (Rainy Day) Fund (1)	1995	2.3%		$ 13,076,000
Other fiscal contingency fund (specify): (2)	1995	None		None
Other fiscal contingency fund (specify): (3)	1995	NA		$121,464,000
~~Disaster Fund~~ Self Insurance Fund (4) Other fiscal contingency fund (4)	1995	100%		$ 70,751,000
Contingency (Rainy Day) Fund (1)	1996	2.5%		$ 15,625,000
Other fiscal contingency fund (specify): (2)	1996	NA		$ 3,000,000
Other fiscal contingency fund (specify): (3)	1996	NA		$131,179,000
~~Disaster Fund~~ Other fiscal contingency fund (4)	1996	100%		$ 85,873,000
Contingency (Rainy Day) Fund (1)	1997	2.6%		$ 17,318,000
Other fiscal contingency fund (specify): (2)	1997	NA		$ 1,320,000
Other fiscal contingency fund (specify): (3)	1997	NA		$138,092,000
~~Disaster Fund~~ Other fiscal contingency fund (4))	1997	100%		$ 98,130,000
Contingency (Rainy Day) Fund (1)	1998	2.7%		$ 19,000,000
Other fiscal contingency fund (specify): (2)	1998	None		None
Other fiscal contingency fund (specify): (3)	1998	NA		$151,044,000
~~Disaster Fund~~ Other fiscal contingency fund (4)	1998	100%		$105,441,000

(1) – Arizona law requires a General Fund budget be adopted in which all available resources shall equal expenditures. No General Fund balances can be budgeted in reserve. Instead, Arizona Statutes allow for contingencies to be included. The amounts shown provide the General Fund Contingency amount. A policy to increase the General Fund Contingency to 3% of operating expenditures was adopted by the City Council in 1995-96. The 3% level will be achieved in 2000-2001. In addition to planned ending fund balances, the enterprise funds also adopt contingencies as well as amounts or percentages that are consistent with the industry volatility. Enterprise Fund contingency amounts a well as the changes in the General Purpose Contingency Appropriation over time are provided in the Summary Budget (see Attachment FM–C, pages 125-126).

(2) – In some years, additional contingency set-asides have been adopted to address changing fiscal conditions. The most common have been for potential reductions in federal grants such as those discussed at the congressional level in the mid-1990s. These amounts are also provided in the Summary Budget (see Attachment FM-C pages 125-126).

(3) – The City maintains an Early Redemption Fund, which is used to manage its property tax-supported bond program. The fund was initially established in 1989 following approval by the voters in 1988 of $1.1 billion in bond authorizations. A $0.20 property tax increase (per $100 of assessed valuation) also was approved at that time to pay the debt service on the property tax-supported portion of the bond program which totaled $529 million. Because the tax increase was implemented immediately following the election, taxes were generated before bonds were actually issued. These taxes were deposited in the Early Redemption Fund. Pursuant to Arizona state law, these property taxes may only be used to pay debt service on general obligation bonds. Additional revenues generated from certain excise and gasoline taxes also are deposited into the Early Redemption Fund to support the property tax-supported debt service.

(4) – A self-insurance reserve is maintained to provide for annual claims and to reserve against future judgements. An independent actuary annually determines the amount that should be added to the fund to achieve 100% funding. This amount is included in the annual budget. Note 13 in the CAFR provides additional information (see Attachment FM-D).

9. What rules govern the transfer of money into and out of the contingency reserve funds? What rules govern the transfer of money into and out of the disaster fund?

Allocations from the Contingency fund require a recommendation from the City Manager and City Council approval. Departments requesting the use of contingency funds must prepare a City Council Report outlining the need and requesting approval to do so. These requests are reviewed by the City Manager's Office and Budget and Research before proceeding to the City Council. Attachment FM-E is an example of a report submitted for City Council action including authorization to use contingency funds.

The Budget and Research Department maintains a status report on the balance of the Contingency fund and prepares a City Council Report on no less than a quarterly basis that summarizes each approved use of and the outstanding balance in the Contingency Fund. The report is also available to the public. A sample is included as Attachment FM-F.

In addition, just before year-end the Budget and Research Department prepares an analysis referred to as the Funding Plan. A copy of the Funding Plan report is included as Attachment FM-G. This analysis reviews current estimates of departmental costs for the year. As part of the analysis, the Budget and Research Department recommends that the appropriation authority associated with the Contingency Fund be formally allocated to cover approved cost increases and any Contingency items approved throughout the year by the City Council. A Request for Council Action is prepared for Council to formally allocate the Contingency Fund. This action assures that the legal appropriation is consistent with actions taken by the City Council throughout the year.

Payments to and from the Early Redemption Fund are planned for in the annual budget process. These payments are based on required debt service payments for general obligation bonds and available secondary property tax revenues. Arizona law requires that all secondary property tax revenues be used for the payment of debt. If revenue exceeds the required debt payments, then the remaining funds are deposited into the Early Redemption Fund.

Payments to the Self-Insurance Retention (SIR) Fund are budgeted annually based upon an actuarial assessment of the requirements to meet 100% funding. Payments from the SIR fund require Council approval and must follow the requirements of the SIR governing ordinance.

10. Aside from the contingency reserve funds you listed above, please describe any other efforts that Phoenix makes to mitigate the budgetary effects of fluctuations in the economy.

Phoenix takes other steps to mitigate economic fluctuations. Following a presentation of prior year budget results to the City Council, as discussed in question 2, the Budget and Research Department begins work on a five-year forecast for the General Fund. Enterprise funds also prepare multiyear forecasts in support of rate setting processes. (Attachment FM–H provides the most recent Five-Year General Fund Forecast.) This analysis includes significant economic indicator forecasts (i.e., personal income). This forecast also includes a multiyear look at significant fiscal issues such as the impacts of state legislation on City costs and revenues, projections for changes in state-shared revenues resulting from the census, and inflationary growth in operating and maintenance costs associated with opening planned capital improvement projects. This information is presented and discussed with the City Council at a regularly scheduled meeting, This provides the Council the opportunity to put current funding decisions in context with expected future conditions.

In economically good times, City management takes steps that will help the City avoid financial crises in periods of economic downturn. For example, in good economic cycles, vehicle replacements and facility maintenance and repairs are provided on a pay-as-you-go basis. In severe downturns, these funds have been provided by short-term lease-purchase arrangements. In addition, increased payments may be made for self-insurance funds thereby allowing reduced payments in poor economic cycles while still maintaining at least 100% funding.

In addition, every effort is made to advise the City Council of the ongoing financial impacts of decisions they make. For example, when approval to apply for grants is sought, the matching requirements are disclosed and discussed in the report. As a result of this approach, the Council took a multi-year approach to planning for the transition of the police officer positions funded by federal grants to the General Fund by setting aside funding in advance of the actual need. The City successfully transitioned 285 police officer positions from federal funds to General Funds.

Another example is the disclosure of full-year operating costs for items that are approved as mid-year additions. This is most easily evidenced in the City's annual budget documents (Attachments FM–C, I, and J). In both the Preliminary City Manager's Budget (FM–I) and Summary Budget (FM–C), operating costs for new capital facilities are shown. The Detail Budget (FM–J) provides full-year costs for items with mid-year start dates (see page 315 for example).

The actions the City took in the early 1990s in response to declining assessed property values provides an example of Phoenix's approach to addressing changing economic climates. During that time, the 1988 bond program, originally planned for five to six years, was reprogrammed twice to stretch out expenditures to ensure our ability to fund both debt service requirements and operating costs for the new projects. In addition, additional revenues were identified and a property tax restructuring were taken.

11. Please describe how the City Council projects revenues and expenditures for both the current and future years. In particular, please tell us how many years projections cover, what method the City Council uses to construct these projections, whether this method involves a consensus process with the city's elected officials, and how these projections are shared with the public.

Preparing detailed revenue and expenditure estimates is the responsibility of the City Manager.

The process for estimating expenditures and revenues is coordinated centrally by the Budget and Research Department. The following is a description of our annual budget process. Our multi-year forecasting process is discussed in questions 10 and 21.

<u>Expenditure Estimates Process:</u>

The expenditure estimates process begins once three months of actual expenditures are available. Departments prepare estimates for the costs to complete the current fiscal year as well as the cost of delivering this year's service levels at next year costs. Salary and benefit costs are projected for the remainder of the current year as well as the ensuing budget year on a position-by-position, month-by-month basis by the centralized budget system (BRASS). Information on the individual benefits and salaries for each position as well as rates of pay are interfaced from the City's payroll and personnel systems into BRASS to ensure the most up-to-date and accurate estimates are prepared. Departments and B&R review the resulting projections for any unusual or one-time items that require correction (i.e., temporary grant-funded positions that will be eliminated when a grant is anticipated to expire).

Following reviews of the salary and benefit cost projections, departments prepare estimates via a centralized, on-line budget system for the remainder of this and next year for all other line items. Estimates are prepared at the lowest level of the organization by line item. Budget and Research staff review these estimates for consistency with historical experience, anticipated inflationary and other increases, proper handling of one-time items such as equipment purchases, and known mid-year changes. Questions are discussed with the individual departments and revisions are made. In addition, B&R performs several citywide centralized analyses such as reviewing all fringe benefits, all utility charges, and citywide salary savings.

This expenditure estimate and review process is conducted from mid-September through December. A second process is typically conducted after six or seven months of actual experience is available. The second process heavily emphasizes further refining the current year estimate so that ending balances can be accurately estimated.

Attachment FM-K provides the instructions departments are given for preparing their expenditures estimates.

<u>Revenue Estimates Process:</u>

The estimating methodology varies by the type and relative contribution of the revenue source to total revenues. In general, there are three primary revenue sources for the General Purpose Fund: local taxes, state-shared revenue, and user fees and other department specific revenues.

Local sales taxes are monitored monthly throughout the year and re-estimated on a monthly basis beginning three months into the fiscal year. By the fifth month, estimates for the ensuing budget year are also prepared. The assumptions used in the Five-Year General Fund forecast are used as the initial basis for projecting overall growth in the local sales tax. A regression model has been developed that uses historical results and forecasts of personal income for the metro area. Judgment is also exercised in applying the results of the regression analysis into developing a final estimate. Particular attention is paid to one-time or unusual circumstances such as audit activity or industry-specific conditions. In addition, the performance of individual categories (i.e., retail sales, construction, amusement) are evaluated for any changing patterns or other influences that may signal an adjustment. Performance of actuals against the monthly estimate is reported in the City Manager's Executive Report. Historical experience is used to distribute the estimate for each category by month throughout the year.

In the case of property taxes, the Finance Department prepares multi-year assessed valuation forecasts in conjunction with its debt analysis processes. An example of a forecast is included as Attachment FM-L. These forecasts are used as a basis for estimating property tax revenues for use in the annual budget process. By mid-March or early April, preliminary assessed valuation estimates are available from the County and are used to update the revenue forecasts for the upcoming budget year. By current policy, the City is holding the combined property tax rate constant. The primary property tax portion, which provides General Fund revenue, is estimated for the upcoming budget year at the current year levy plus an amount for new construction. By taking this approach, the City is slowly lowering the primary rate and increasing the secondary rate to generate additional resources for debt repayment in order to prepare for a new bond program.

For state-shared revenues, both the City's relative population to the state as a whole and the actual state revenue stream from shared sources must be estimated. For the most part, the City does not rely on the state's revenue estimates. In all cases, known changes to the state's revenue stream or sharing ratios made by state legislation are accounted for in these estimates.

Historical relationships between growth in local and state sales taxes as well as economic indicators are used to estimate state sales tax revenue.

For motor vehicle taxes, substantial changes in the rates and distribution methods have been experienced in recent years, so much of the forecasting has required careful analysis of the impact of legislative changes.

Income taxes are shared with cities and towns two years following actual collection at the state level. As a result, the City relies on Arizona Department of Revenue estimates for state-shared income tax amounts.

Measures of relative population changes are based on historical experience and other entity and Planning Department estimates of populations.

In the case of department-specific revenues, the Budget and Research Department conducts a centralized process to gather estimates from departments, including enterprise operations. B&R staff review these estimates and discuss the assumptions used to generate them. These discussions focus on historical patterns, economic or other indicators, and rate or programmatic changes that could impact a particular revenue source. For example, the planned opening of a new parking garage will generate new revenue for that garage, but may mean a slight reduction for other garages in the vicinity. Departments submit revenue estimates twice during the year and in both cases, prepare their estimates for the remainder of the current year and for the upcoming budget year. Narrative explanations of the methodology underlying the estimates are deemed as important as the estimates themselves. Attachment FM-M is an example of the instructions provided to departments for preparing their revenue estimates.

A complete description of revenue estimates is included in the Summary Budget document (see Attachment FM-C, pages 49-64). Lastly, routine, periodic budget discussions are conducted with the City Council. The 1999-2000 schedule was as follows:

Topic(s)	**Month Scheduled**	**Attachment(s)**
Review Prior Year Actual Results	November	FM – B
Five-Year General Fund Forecast	January	FM – H
Initial General Fund Budget Status, reports the results of the initial revenue and expenditure estimate processes	February	FM – N
City Council Ratings Requests; two requests, one for broad category ratings and one for specific program/services ratings	January & March	FM – O
Trial Budget	April	FM – P
Newspaper Inserts & Public Hearings	April –May	FM – Q
City Manager’s Budget	May	FM – I
Final Council decisions and adoption	May-June	
Property Tax Levy	July	

12. Please answer the following questions about investment policies and practices in Phoenix*, excluding the investment of pension funds:*

a. Please summarize Phoenix’s current investment portfolio, investment strategy, and management of the investment process. In so doing, please include a description of any written policies and procedures governing investments Phoenix uses, any benchmarks for investments Phoenix uses, and how Phoenix tracks performance relative to those procedures and benchmarks. In particular, please explain and provide evidence about how Phoenix optimizes return on investments within acceptable risk.

A summary of the City’s current operating portfolio (the Treasurer’s Pool) and summary investment guidelines are included in Attachment FM-R.

Legal and policy constraints define the maximum risk profile of the portfolio to achieve the objectives of liquidity, safety and return.

The City's strategy in managing its operating portfolio focuses on managing its cash flow requirements. Current cash flows are analyzed monthly for patterns and trends, and then compared to historical and future anticipated cash flows. The portfolio is then managed to parallel the anticipated cash flow needs from operations. Investment selection is made within legal and policy constraints. In addition, a portion of the operating portfolio is kept highly liquid and managed daily along with all monies at the City's servicing bank to meet any unanticipated cash outflows that may arise.

Cash flow requirements, market conditions, portfolio position and relative values of investment alternatives are evaluated in a weekly meeting with the Finance Director, City Treasurer, Investment Manager and Treasury staff. Portfolio modifications are then made, if required, to optimize returns given the legal and policy constraints of the portfolio.

Because the portfolio changes characteristics (duration and average life) over time based upon anticipated cash flow requirements and is not managed in the same way as major market benchmarks, (e.g., Lehman Indices) no single benchmark is utilized to measure performance. The portfolio is measured twice monthly against the current market.

b. How frequently do investment accounting policies and procedures require information concerning cash position and investment performance to be reported, and to whom is this information reported?

As noted in the above response, weekly meetings are conducted with the Finance Director, City Treasurer, Investment Manager and Treasury staff.

c. What formal oversight mechanisms exist for monitoring investment activities? Is there an independent body that oversees investments? If so, how active is this body?

See 12a.

d. What has Phoenix's annualized return on investment been for the following fiscal years, by quarter?

FY	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
1996	5.929	5.878	5.623	5.482
1997	5.524	5.716	5.802	5.975
1998	6.130	6.127	6.102	6.025

e. Has Phoenix recently experienced any problems with its investment practices? If so, please explain these problems and how they were addressed.

No.

f. Has Phoenix recently implemented any significant changes to its investment policy? If so, please describe the nature of these changes.

Changes in reporting requirements resulting from the implementation of GASB 31 were reflected in the City's 1998 CAFR, but these had no effect on the City's investment policy/guidelines.

13. Please answer the following questions about investment policies and practices in Phoenix, *for the investment of pension funds for your most significant pension plan(s):*

a. Please summarize Phoenix's current investment portfolio, investment strategy, and management of the investment process for pension funds. In so doing, please include a description of any written policies and procedures governing investments Phoenix uses, any benchmarks for investments Phoenix uses, and how Phoenix tracks performance relative to those procedures and benchmarks.

The City of Phoenix, Arizona Employees' Retirement Plan is a single-employer defined benefit pension plan for all full-time classified civil service general City employees. Included as Attachment FM–S is a summary of Plan Assets as of March 31, 1999. In addition, the Investment Policy of the Retirement Board including Fund Manager Guidelines for each fund manager are also provided as Attachment FM–T.

b. How frequently do investment accounting policies and procedures require information concerning cash position and investment performance for pension funds to be reported, and to whom is this information reported?

Investment performance is presented to the Retirement Board quarterly by the Plan's financial adviser. Fund managers provide written performance reports to the Board monthly, and are required to make semi-annual presentations to the Board concerning performance at a Board meeting.

c. What formal oversight mechanisms exist for monitoring investment activities? Is there an independent body that oversees investments? If so, how active is this body?

See the Board policy included as Attachment FM-T.

d. Does Phoenix have an unfunded pension liability? If so, what is it in absolute terms and as a percentage of total liability? To what do you attribute any liability (for example, conservative assumptions, structural underfunding, etc.)?

All full-time employees and elected officials for the City are covered by one of three contributory pension plans. In addition to normal retirement benefits, all of the plans also provide for disability and survivor benefits, as well as deferred pensions for former employees. Pension benefits vest after five years for general City employees and elected officials, and after ten years for public safety employees.

The City of Phoenix, Arizona Employees' Retirement Plan is a single-employer defined benefit pension plan for all full-time classified civil service general City employees. The actuarial accrued liability of the plan is measured in accordance with the requirements of Governmental Accounting Standards Board Statement No. 25 and No. 27. As of June 30, 1998, net assets available for benefits were greater than the actuarial accrued liability by $11,453,000.

The City of Phoenix also contributes to an agent multiple-employer defined benefit pension plan, the Arizona Public Safety Personnel Retirement System for all sworn police officers and firefighters. The APSPRS functions as an investment and administrative agent for the City of Phoenix with respect to the plans for police officers and firefighters. The actuarial accrued liability of the plan is measured in accordance with the requirements of Governmental Accounting Standards Board Statement No. 25 and No. 27. For Police, the funding value of accrued assets exceeded the actuarial accrued liability by $116,650,000 as of June 30, 1998. For Fire, net assets available for benefits exceeded the actuarial accrued liability as of June 30, 1998 by $66,594,000.

The Elected Officials' Retirement Plan of Arizona is a cost-sharing multiple-employer defined benefit pension plan which is administered by the Arizona Public Safety Personnel Retirement System. The City of Phoenix is a contributing employer, and contributes an actuarially determined amount to fully fund benefits for active members, which include the Mayor and City Council.

For a detailed description of each plan, please refer to Attachment FM–D, Note 20, in Notes to the Financial Statements. Additional information on the City's general employees' plan is included in Attachment FM–U, which is the Comprehensive Annual Financial Report for the plan for the fiscal year ended June 30, 1998.

e. What actuarial assumptions does Phoenix make with respect to its pension funds? (For example, what rules govern retirement eligibility? What is the age of the workforce? What is the expected rate of return on investments?)

The actuarial assumptions for all of the City's plans are shown in Attachment FM–D, Note 20, in the Notes to the Financial Statements. Additional information on actuarial assumptions used in the City's general employees plan are included in Attachment FM–U in the actuarial section.

f. What has Phoenix's annualized return on investment for pension funds been for the past three fiscal years, by quarter?

The following table reflects return on investment for the City's general employees' plan:

FY	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
1998	7.6	0.3	8.8	0.8
1997	3.6	3.9	-2.3	11.1
1996	6.8	4.9	2.2	2.9

g. Has Phoenix recently experienced any problems with its pension investment practices? If so, please explain how these problems were addressed.

No.

h. Has Phoenix recently implemented any significant changes to its pension investment policy? If so, please describe the nature of these changes.

No.

14. Please answer the following questions about debt policies and practices in Phoenix:

a. Does Phoenix have a formal, written debt policy? If so, is it required by state or City statute, executive order, or administrative rules? What other procedures and practices are followed to manage debt in Phoenix, including both general obligation debt and revenue debt?

Policy and practices with respect to debt are detailed in the Present Debt Position Report that is included as Attachment FM-V.

As a general rule, the City has given priority to using general obligation bonds for capital programs of general government departments (non-enterprise departments). These programs include Fire, Library, Mountain Preserves, Parks and Recreation, Police and Storm Sewers. The annual debt service on general obligation bonds issued for these non-enterprise purposes is paid from a portion of the total annual property tax levy. Arizona State law required that the secondary property tax levy only be used for the payment of principal and interest on long-term obligations; the primary levy is for current operating expenses. Consequently general obligation bonds issued for non-enterprise purposes influence the annual property tax rate.

In the water and airport programs, the City has made substantial use of revenue bonds secured by and paid from the revenues of these enterprises (the typical utility revenue bond financing approach). In addition, the City also has used general obligation bonds for water and airport purposes when deemed appropriate, with annual debt service on these bonds paid from the revenue of these enterprises, rather than from property taxes or other general revenues. General obligation bonds are also used for the sanitary sewer (wastewater) and solid waste disposal capital improvement programs, with the annual debt service paid from the revenues of each respective enterprise system.

This deliberate policy of using revenue bonds and servicing general obligation bonds issued for enterprise purposes from enterprise revenues is viewed favorably by municipal bond analysts. It permits maintenance of a low-to-moderate debt burden, that is, the amount of debt that must be supported by the property tax base. This is a key measure evaluated by analysts in assessing debt position.

b. Please describe how Phoenix's debt management practices protect it against future risk. For example, does Phoenix have one or more debt capacity models? If so, how does Phoenix monitor actual performance compared to these models? Which economic and demographic variables does Phoenix project? How does Phoenix evaluate its existing debt burden and debt service requirements?

As described below in response to question 14c, general obligation-bonded debt is subject to certain debt limitations imposed by Arizona State law. Each time general obligation bonds are issued, a debt limit calculation is performed. This calculation is also presented in the Comprehensive Annual Financial Report as well as in the annual operating budget. The general obligation bond borrowing capacity as of March 1, 1999, is shown on Attachment IV of the Present Debt Position Report (Attachment FM-V).

Debt burden is also evaluated on a regular basis by relating net direct debt and overall net debt to the broadest and most generally available measure of wealth of the community: the assessed valuation of all taxable property and assessed valuation adjusted to reflect market value. In addition, net debt can be related to population to determine net debt per capita. These comparisons are made each time bonds are sold, and are reflected in the official statement (bond prospectus) that is distributed to prospective investors. These calculations are also presented in the Comprehensive Annual Financial Report. A detailed discussion on the debt position is included in the Debt Position Analysis section of Attachment FM-V.

The City uses a debt capacity model for its property tax-supported bond program, which projects future property tax-supported debt service, assessed valuation and corresponding property tax levies, other revenues and estimated redemption funds available for the payment of debt service. This analysis is updated each time the City sells property tax-supported general obligation bonds and is reviewed with the rating agencies before each sale. Question 21 includes a discussion and example of such forecasts.

For the aviation, water and wastewater enterprises, pro forma financial forecasts have been developed that provide a five-to-ten year forecast of all revenues and expenses for the respective funds. The forecasts include all operation, maintenance and capital needs, including current and proposed debt service requirements, over the forecast period. These projected expenses are compared to available revenues to determine rate increases necessary to maintain adequate fund balances and debt service requirements over the forecast period. These forecasts and the underlying assumptions are also reviewed by independent engineering and financial consultants whenever financing is undertaken. The consultant reports are included in the official statements that are distributed to prospective investors.

c. Does your state or City limit debt issuance? If so, in what ways? To what types of debt do these limits apply?

Under Arizona law, the City is authorized to issue voter-approved general obligation bonds, which are legally secured by a pledge to levy secondary property taxes without limit to make the annual principal and interest payments on the bonds. Under the provisions of the Arizona Constitution, outstanding general obligation bonded debt for combined water, sewer, lighting, parks, open space and recreational purposes may not exceed 20% of net secondary assessed valuation. Outstanding general obligation bonded debt for all other purposes may not exceed 6% of net secondary assessed valuation. The City's general obligation bond borrowing capacity as of March 1, 1999, is shown on Attachment IV of the attached Present Debt Position Report (Attachment FM-V).

In addition to general obligation bonds, under Arizona law, the City is authorized to issue voter-approved highway user revenue and utility revenue bonds, which in our case include water revenue and airport revenue bonds. The highway user revenue bonds are secured by state-shared gasoline taxes and other highway user fees and charges, and are not a general obligation of the City. The water and airport revenue bonds are secured by a pledge of revenues from these respective enterprises, and do not constitute a general obligation of the City backed by general taxing authority. Both highway user revenue bonds and utility revenue bonds are not subject to the Constitutional debt limit.

15. Please answer the following questions about accounting:

a. What is Phoenix's basis of accounting for the budget (For example, cash, accrual, modified accrual, etc.)?

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

The modified accrual basis of accounting is used for governmental funds, expendable trust funds, and agency funds. Revenues are recognized when susceptible to accrual (i.e., when they are both measurable and available). "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. The City considers property taxes as available if they are collected within 60 days after year end.

The City's basis for budgetary accounting is primarily modified accrual, with some differences. The Summary Budget document, included as Attachment FM-C includes a discussion of differences between budgetary and financial accounting on page 43. The major difference in budgetary from modified accrual include:

- Encumbrances are treated as expenditures instead of being treated as a reservation of fund balance
- Grant revenues are recognized on a modified cash basis instead of being accrued.
- In-lieu property taxes are treated as interfund transfers instead of reimbursable expenses.
- Staff and administrative costs are treated as interfund transfers instead of reimbursable expenses.
- Reservations of fund balance are not recognized.

b. When does Phoenix recognize revenues in the general fund?

The general fund is a governmental fund and uses the above-referenced accounting method. Revenues are recognized when susceptible to accrual (i.e., when they become both measurable and available). Revenues susceptible to accrual include property tax; privilege license tax (sales tax); state-shared sales, income and vehicle license taxes; and interest earned on investments. Licenses and permits, charges for services, fines and forfeitures, parks and recreation charges and miscellaneous revenues are recorded as revenues when received because they are generally not measurable until actually received.

c. When does it recognize expenses in the general fund?

Expenditures are recorded when the related fund liability is incurred.

d. Are these same recognition rules used for other funds in which revenues represent more than 5% of total City revenues? If not, specify what rules are used for these funds.

Enterprise funds and pension trust funds are accounted for on a flow of economic resources measurement focus whereby all assets and liabilities associated with the operation of these funds are included on the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings components. Operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets. The accrual basis of accounting is followed for these funds whereby revenues are recognized in the accounting period when they are earned and become measurable, and expenses are recognized when incurred.

16. Please describe any efforts Phoenix has made in developing cost accounting. For example, does Phoenix use a formal activity-based or managerial cost accounting system? How do these or any other cost accounting policies and procedures enable program managers to determine their unit and total costs (including indirect, support, and other costs charged to other appropriations and/or agencies) that are incurred for operating that program?

The City took a major step forward in cost accounting when, in July 1998, we began using a new financial management system, SAP R/3. The SAP software is highly regarded by the business community as a "best practices" system. In fact, at the time the City purchased SAP, Fortune magazine indicated that six of the top 10 Fortune 500 companies used the software.

The SAP software includes a cost-accounting module that supports all types of cost-accounting needs, including activity based costing. Before the implementation of SAP, the City was already advanced in its use of cost accounting for purposes such as rate and fee setting and interdepartmental and interfund charges. However, more than 100 small "shadow systems" were used throughout the organization to maintain cost accounting data. At that time, data was downloaded from the City's financial accounting system or re-keyed to the cost-accounting systems. To meet existing cost-accounting needs, the City implemented the following

SAP cost-accounting functionality: activity charges, internal orders, cost-center accounting, profit-center accounting, assessments, surcharges, and distributions.

Departments now use SAP for their cost-accounting information. Because SAP is a fully integrated system, the cost accounting module is updated real-time from financial transactions as they occur in the other SAP modules, making the data immediately current and available. The process of waiting for downloads and/or re-keying is no longer necessary.

Cost accounting was an important consideration for Phoenix when purchasing a new financial system because the information is used in many decision-making processes. Following are discussions of several examples of how cost accounting information is used.

- Cost-based user fee charges are used to charge for services such as water, solid waste collection and disposal, and airport landings.
- User fee analyses include allocation of central service (staff and administrative) costs such as centralized payroll, financial accounting, and purchasing activities. These costs are now calculated and allocated in SAP using more than 20 different allocation bases ranging from number of financial transactions to budgeted costs. The allocations are made to more than 3,000 cost centers.
- Cost-accounting information is also used in the competitive bidding program referenced in question 22. Incremental cost analysis is used to determine who should provide services to the public (such as refuse collection or ambulance service). Cost analysis is also important for Federal grant cost recovery. In these cases, the Federal Government often dictates special requirements.
- The City also uses cost accounting for departmental decision-making (i.e. "How much does it cost the City to perform a certain activity and should this activity be discontinued?"). SAP can be used to assist in this analysis.

Moving departmental cost-accounting modules into SAP required a great deal of time and effort from department and central staff. The modules were tested extensively before running in production environment. Users actively participated in adapting the SAP cost-accounting module to meet their various needs. Users met every two weeks and developed a new cost-accounting chart of accounts, defined security, developed forms, conducted formal training, and participated in system testing. The user group (composed of one person from each operating department) meets monthly to set priorities for cost-accounting enhancements including expansion of ABC costing as well as reporting and continuing training needs.

17. How is money appropriated (for example, by programs or by line items)? How much flexibility do agency managers have to move funds among departments, programs, and line items? What are the limits to this flexibility?

Legal appropriations are made at the program level for the General Fund and generally at a fund level for the remainder of the budget. Pages 598-631 of the Detail Budget document included as Attachment FM-J provides the legal appropriation ordinances used to adopt the 1998-99 operating, capital and reappropriations budgets. In the absence of City Council approval, legal appropriations cannot be moved between individual appropriated areas.

Effectively, individual departments prepare and view their budget appropriations and related estimates at the lowest organizational, line items and fund levels. Within a department, managers may move funds between suborganizational units and objects at their discretion. However, any programmatic or service level changes require City Council approval. In practice, the expenditure estimate and review process described in question 11 is used to allow managers to appropriately modify their budgets.

In addition, the Performance Achievement Program that is used to compensate departmental managers includes a measure of actual expenditures to the original budget. This approach allows managerial flexibility but reserves the approval of service level changes for the City Council.

18. What controls exist to guard against unauthorized or fraudulent spending in excess of authorized amounts?

A number of controls exist. Some are classic internal controls such as separation of duties, rules and procedures that require varying approvals, especially where cash handling exists; an audit program; public reporting of monthly results; and mid-year reviews of actual expenditures to budgets and estimates with the Budget and Research Department. Others are less direct such as ties between compensation and performance and monthly reports of department results measures. The following briefly discusses some of the controls in place; the audit program is discussed in a subsequent question.

As described in the previous question, manager compensation changes are, at least in part, tied to performance relative to the adopted budget and also to the delivery of certain levels of service. Monthly reports, the City Manager's Executive Report, include key measures of performance for each department and the City as a whole. These reports are distributed to City management and the council. This report is discussed in more detail in question 25.

The use of a process in which departments are permitted to revise their estimates to reflect current costs and conditions means that justifiable increases are evaluated as the year progresses. Also, a review of actual expenditures to the estimated level by Budget and Research in two formal expenditure estimates processes and on an ad hoc basis throughout the year. Department fiscal staffs also review their monthly expenditures against planned expenditures and look for inconsistencies.

The City has established procedures, regulations and policies that require certain approvals and, in many cases, City Council action for payments, entering into contracts and for processing change orders to contracts. In some instances, the new SAP financial management system (discussed in questions 24 and 26) adds a workflow element that requires certain purchasing or accounting documents be electronically routed to the appropriate approvers before the transaction can be completed. A monthly financial report is widely distributed and includes comparisons of budgeted to actual amounts as well as comparisons of prior year-to-date data with current year data. An example of the Monthly Financial Report is included as Attachment FM–W.

19. Please explain who conducts audits in Phoenix (an internal office, independent entity, or both) and describe Phoenix's audit process.

The City has both an internal office and an external independent auditor as well as an oversight and review committee in its overall audit program. A City Auditor is established in the City Charter. In addition, Arizona law requires that all cities prepare financial statements and that these statements be audited by an independent certified public accountant. The internal auditor also will contract with external audit firms for specialized one-time unique or complex needs, such as in the fast-paced information technology field. Finally, an Audit Committee is also in place that includes membership from City management and the City Council.

In Phoenix, the City Auditor Department performs internal audits and manages the contract with the external auditor for the audit of the City's annual financial statements. The external auditor does rely on the internal audit program. The City Auditor Department does not prepare the City's financial statements.

The City Auditor Department (CAD) performs financial audits such as reviews of contracts, internal controls, accounting for and safe keeping of assets, financial information systems, and rate and fee recovery rates. CAD also performs program evaluations to determine whether programs or services are meeting established goals and ad hoc audits to respond to issues or concerns raised throughout the year. Another role of the internal audit function is in the City's competitive bidding process. In this role, costs included in the City's bid proposal as well as service level compliance, and cost compliance if the City is the provider, are all audited for the delivery of the contracted service. The City Auditor Department, also identifies process, cost or other improvements to help departments improve service delivery as well as work, with departments and their customers to determine how to best measure the department's results.

The City Auditor Department performs audits in accordance with Generally Accepted Government Auditing Standards. The standard audit process includes:

- Hold opening conference with the audit client
- Perform survey work and an evaluation of internal controls
- Develop an audit program
- Issue a commitment memo to the client including the objective, budget and target report date
- Perform testing and field work
- Hold exit conference with client to review findings
- Prepare and issue to the client a draft report
- Hold closing conference with client to discuss report wording and recommendations
- Issue revised draft report with instructions for the client to prepare a response
- Issue final report with client response (issued to the Department head, responsible Deputy City Manager, City Manager, and the Audit Committee; reports are also included in the standard City press packet and are available to anyone as a public document)
- Follow up on outstanding items at each year end

An audit plan is prepared each year by the City Auditor that provides broad coverage across the City organizationally and by type of audit. In addition, a six-year audit plan is also developed. The audit plans address an established goal to audit every major area of financial risk at least once every six years with many being on a more frequent basis. The plans and the results are reviewed with the Audit Committee.

The City Auditor Department also goes through a peer review process.

20. Please describe the processes Phoenix has in place for assessing the future financial impact of legislation. (For example, does Phoenix have a fiscal note process in place? How far into the future do these assessments extend?)

Phoenix is careful to evaluate the impact of all changes proposed by the City Council, State Legislature, and Federal Government. The City has an Office of Intergovernmental Programs (IGP) that is charged with coordinating legislative review, lobbying on behalf of the City and maintaining other intergovernmental relationships. In addition, IGP manages contracts with lobbyists who work at both the state and federal levels on behalf of the City.

For internally proposed new programs or changes, the standard City Council Report format and process requires the presentation of any fiscal impact. Action steps in such reports often require that the City Council adopt the program element included in the report as well as provide for any required funding through the use of contingencies or creation of new revenues. City Manager's Office and Budget and Research staff review the financial impacts of items going to the City Council. This is one of the elements included in weekly agenda planning meetings. An example of a City Council Report with a Financial Impact is included as Attachment FM-E.

Requirements exist to guide departments seeking City Council approval to apply for a grant. One of those requirements is that information on matching funds required be discussed in the report so that the Council can make an informed decision about the full impact should the grant be awarded. This and other guidelines for seeking grants were established in a citywide review of grant programs and processes.

The IGP staff are active in the State legislative process. They attend legislative sessions and committee meetings to monitor and track bills that are proceeding through the legislative process. This includes receiving and reviewing all proposed Senate and House bills. In their initial review, IGP staff determine if other City departments should review and comment on a bill. All bills with a potential financial impact to the City are reviewed by the Budget and Research Department. Those with sales or property tax law changes are reviewed both the Finance and Budget and Research departments. These departments estimate the near and longer term impact on City revenues or expenditures. The duration of projections into the future are dependent on the bill itself. For example, bills that proposed tax increment financing for certain projects are evaluated for the full life of the proposed tax deferment. Other bills are evaluated for the immediate and upcoming year impact. Recently, the State of Arizona moved to biannual budgeting. As a result, analyses were prepared to estimate the impacts over multiple years.

IGP staff reports on a weekly basis to the City Council during the state legislative sessions. They seek policy guidance from the City Council and provide the estimated impacts of bills they discuss with the City Council in their reports. An example of a report on State legislation is included as Attachment FM-X.

Federal legislative analysis is generally performed by the contract lobbyist in conjunction with IGP and potentially affected departments. In the mid-1990s when substantial federal funding cuts were being discussed, a team was formed of staff from IGP, the City Manager's Office, Budget and Research, significant federal grant-receiving departments and our lobbying firm. The team met nearly weekly to quantify the potential financial and service delivery impacts of proposed reductions. Reports were made regularly to the City Manager and City Council as federal legislation progressed.

Known changes from enacted federal, state or local legislation are incorporated into the previously mentioned Five-year General Fund forecast.

21. Please describe any requirements Phoenix has in place to estimate the outyear effects of the budget (more than just the budget year, and perhaps as many as five years), in order to guard against future surprises. (These may include, for example, estimates of pension liability or accrued vacation and sick leave.)

The Budget and Research Department annually prepares a Five-Year General Fund forecast that incorporates anticipated changes in revenues and expenditures, included as Attachment FM-H. This forecast includes providing for impacts such as a decline in state-shared revenues following a census, future impacts to state-shared revenues because of legislative changes, estimated net operating costs or savings from projects programmed in the five-year capital improvement program, as well as cost of pay-as-you-go funded capital improvement projects. Economic influences and factors are also incorporated into this analysis.

The Capital Management section of this survey includes discussions of preparing estimates for operating budget impacts of proposed projects and an attachment of a capital needs study that includes such estimates. The annual budget process includes the impact of added costs for capital projects scheduled to open in the new budget year, and if mid-year, also discloses the full-year cost anticipated in the following year. These full-year costs are incorporated into the Five-Year General Fund forecast.

Pension and sick leave trusts are established and funded based on actuarial forecasts. Debt repayments are estimated for the life of the debt instrument and are discussed in the financial statements and annual budget document. Pro-forma analyses are conducted for enterprise funds for five or more years for rate-setting and debt-analysis and issuance purposes. For example, analyses for the solid waste enterprise would include estimates for equipment replacements, growth in households served, and opening and closing of landfills. These forecasts are used as a means to provide gradual annual fee increases rather than large periodic rate increases.

An example of attention to this concept is highlighted by a current effort to evaluate the potential of the City undertaking a new G.O. Bond program. The Mayor has appointed a citizen Fiscal Capacity Committee to study the City's capability of taking on new debt. The committee already has reviewed staff-prepared multiyear forecasts for assessed valuation and the impact on varying levels of new general obligation bonds on debt service and supporting secondary property tax revenues through fiscal year 2021. The committee recently has begun to discuss concepts for providing for funding of operating costs of projects that might be approved in a new bond program. Members are studying the costs of operating the projects implemented through the 1988 bond program and are expected to provide guidance and recommendations to a future citizens bond committee. Attachment FM-Y includes a set of the assessed value, secondary property tax and debt service forecasts reviewed by the committee.

22. Please answer the following questions about contracts for the provision of public services:

a. What major activities or functions (for example, jails, sanitation, or ambulance services) are contracted out by Phoenix government?

Contracts, in place via private/public competition or standard bidding processes, are used to deliver public services in the areas of residential refuse collection, custodial services, landscape maintenance, bus stop maintenance, copies/printing services, dead animal collection, vehicle towing, temporary employment needs, fuel storage and security guard/patrol services. In addition, all construction of public works buildings, streets, and similar projects are contracted.

b. What is the total value of contracts that Phoenix government had for the delivery of public goods and services in fiscal year 1997? Fiscal year 1998?

Description	FY 97 Amount	FY 98 Amount
Public Services	$215,623,000	$245,496,000
Public Works Construction	$223,948,000	$269,256,000

c. How are these contracts evaluated? In particular, does Phoenix use formally established performance criteria? If so, what percentage of contracts are covered by such criteria?

Contracts for the supply of goods and nonprofessional services are evaluated primarily on the basis of price, in conformance with product/service specifications set forth in public procurement documents. Contracts for supply of professional services and more complex services, such as residential refuse collection, may use specified performance criteria as a factor in the evaluation process. It is difficult to provide a percentage of contracts covered by performance criteria, but the following description provides an example of the use of performance criteria in a complex service contract.

In the Public Works area, where both public/private competition and typical public bid processes are used, contracts have historically included penalties for failing to meet basic performance requirements. Examples would be adherence to the published uncontained bulk collection schedule. Attachment FM-Z is a list of penalties included in the most recent of these contracts. For the most recent residential collection competitive process, additional performance standards and penalties were added to the contracts. Two contractors are subject to a performance evaluation after two years to determine whether the contract should be continued, with annual reviews thereafter. Attachment FM-AA is a copy of such performance standards. The standards include measures such as adherence to basic contract provisions and customer satisfaction as measured by independently performed surveys.

d. How are contracts monitored? Is there a formal process for tracking contracts? Is a central government office responsible for overseeing the contracting process and the contracts themselves?

Contracts are monitored primarily by the City department for which the services are being provided. A formal process is in place for tracking the contracts, so that any options to extend an agreement are properly exercised, and that the rebidding process is started and completed timely. The Purchasing Division of the Finance Department oversees the contracting process. In the case of public/private competitions where a City department is bidding, the City Auditor is involved in reviewing the calculation of the City's bidding price. Attachment FM-AB is a booklet that explains the public/private competitive process.

The following are examples from two departments to demonstrate how contracts are monitored:

The Engineering and Architectural Services Department (EAS) manages contracts for construction of public works projects. EAS monitors contracts both monetarily and qualitatively. Payments are monitored through review of requests by project managers, requirement of department head approval, cost-tracking in the financial system and via a process that requires City Council approval for change orders of over specified percentages. Qualitative monitoring is performed by the project manager and inspector assigned to the project. The project manager monitors the contractor to ensure the project remains on budget and schedule, and the inspector verifies that proper methods and materials are used throughout the project.

In the Public Works Department, contracts are monitored in two ways: compliance with broad contractual requirements (i.e., performance bond, Affirmative Action, insurance) and compliance with specific operational requirements (i.e., operational plan, training and safety plan, ongoing delivery of services). (See Attachment FM-AC for an example of an operation plan, training and safety plan and ongoing service delivery plan that are used to evaluate contractor performance.) The contract monitor staff work closely with the Law and City Auditor departments and Purchasing to develop the bid and contract documents. In the case of serious performance problems, particularly if they relate to default, the contract monitor staff work closely with the service area (e.g., solid waste) and Law Department staffs to ensure that all appropriate steps are taken to enforce contract requirements. For broad requirements, activities such as daily monitoring of performance, verifying financial obligations, and responding to customer complaints are performed and discussed with the contractor regularly.

e. Please explain any policy Phoenix has that dictates how quickly contractors must be paid.

Arizona law requires that construction contractors be paid within 21 calendar days of billing, except for the final billing, which requires payment within 60 calendar days of final acceptance of the project. The City is in compliance with this requirement. No written policy is established for other payments. Other types of contracts include payment terms. For example, in the solid waste collection areas, contracts are paid in arrears based on a count of containers collected. The contractor is given a house count and has ten days to protest. Once payment is authorized, payment is typically sent within 30 days of month end.

23. Please answer the following questions about procurement:

a. Please explain any formal, written policies and procedures that Phoenix has that govern procurement.

Policies and procedures for the procurement of goods and services are embodied in various Administrative Regulations issued by the City Manager's Office. Construction contracting is governed by Arizona law and applicable local ordinances. An index of the City's Administrative Regulations (ARs) is included as Attachment FM-AD and all ARs are available on the City's Intranet for use by employees.

b. Please describe how the procurement process works for the purchase of major items. What dollar value does Phoenix consider to be a major purchase?

The Purchasing Division of the Finance Department conducts a formal bidding process for goods and nonprofessional services with a contract value over $20,000. This involves the preparation of a written Invitation for Bid (IFB) or Request for Proposal (RFP), which sets forth the required product/service specifications and contract provisions. The bid responses or proposals are opened at a public opening and recorded by the City Clerk. Any resulting contract is then awarded by formal action of the City Council. Contracts for goods and nonprofessional services valued under $20,000 are processed by Purchasing using a less formal procurement process; such purchases are conducted with as much of a competitive process as possible. Contracts for the provision of professional services are handled directly by the department needing the services in accordance with Administrative Regulations issued by the City Manager's Office. The Engineering and Architectural Services Department manages design services procurement in conjunction with departments.

c. Is a central government office responsible for overseeing procurement?

No single entity is responsible for overseeing all procurement. The City has centralized the procurement function in the Finance Department for the purchase of goods and nonprofessional services where the purchase price exceeds $1,000. Purchases below that amount, as well as the procurement of professional services, have been delegated to City departments directly, within the guidelines set forth in

Administrative Regulations. All public works construction contracting is centralized in the Engineering and Architectural Services Department.

d. How much flexibility do agency managers have to procure items they need?

As noted above, departments do have the flexibility to directly manage procurement of goods and non-professional services valued under $1,000. In addition, they are directly responsible for procurement of professional services needs.

24. How well do Phoenix's information technology systems support financial management? (For example, do the available information technology systems do a good job of supporting the timely and accurate acquisition, use, and reporting of financial data?) Are Phoenix's budgeting and accounting systems separate or integrated (i.e., share a common data base)? What actions are under way to address any deficiencies?

As noted previously, the financial management technology systems took on a new look during fiscal year 1998-99 when the City successfully implemented the SAP R/3 system for fiscal year 1999. SAP is a client/server-based enterprise management system that tightly integrates financial and operational processes and their related information. Before SAP, several independent mainframe, legacy systems were in place. We replaced these systems when the following SAP modules were implemented:

Financial Accounting and Treasury

General Ledger, Special Ledger, Accounts Payable, Accounts Receivable, Fixed Assets, Bank Reconciliation, Budgetary Accounting and Reporting, Financial Accounting and Reporting

Materials Management

Purchasing, Inventory, Warehouse Management

Sales and Distribution

Customer Billing

Controlling

Cost Accounting, Cost Allocations, Activity Charges, Internal Orders

Project Systems

Capital Project Accounting

Electronic Workflow

Purchase Requisitions, Payable Invoices, Journal Entries

The City has more than 900 SAP users. The system is available to all City departments, which then determine how to best deploy the system within their department (i.e., degree of departmental centralization of major business processes). All departments have elected to use inquiry and reporting capabilities throughout their departments.

Financial management is well-supported through the SAP system's provision of real-time, online information to departmental managers on which to base decisions. Before SAP, real-time access was not possible. In addition to improved support of financial decision making, better customer service to our vendors is possible. As an example, the current status of invoices is immediately available.

Under the old, legacy systems, accessing information was more cumbersome. Users received hard-copy reports or, in some cases, they received electronic downloads of monthly reports. Users electing downloads would reformat the information into management reports and respond to any inquiries. With SAP, on-line tools are provided to reformat and print reports immediately at the user's workstation without having to download. But, if the user does prefer to download the data for further analysis, SAP also provides this flexibility.

An additional feature of reports within SAP is the "drill down capability." Viewers of a report can select a line item in a report and, by clicking on the item, can "drill down" to the original postings that make up the line item. The SAP system has significantly increased the availability and timeliness of information to all levels of our organization.

Further, because of the flexibility and integration of the SAP system, we are able to accommodate three bases of accounting: Budgetary Accounting, GAAP Accounting, and Cost Accounting. Budgetary accounting, control, and reporting are accomplished in the funds management module of SAP. Financial accounting and reporting is accomplished within the general and split ledgers portion of the system and cost accounting and reporting is accomplished within the controlling module.

Separate documents are simultaneously posted to each relevant module for every transaction. This integration has significantly reduced duplicate data entry of financial transactions and means that, within the same system on a real-time basis, a manager can view cost accounting reports to evaluate the current cost of a service and also view the current status of the department budget.

Because the SAP system is still relatively new to the City, increased measures are in place to address financial systems support issues as they surface. These measures include a telephone/e-mail Help Desk function, a Project Team that addresses technical issues, a Transition Team whose members serve as liaisons to each department with regard to SAP and several functionally related user groups. The users groups meet regularly to address issues for SAP as well as the BRASS budget system that is discussed in the next few paragraphs.

In conjunction with implementation of SAP, the citywide budget system was also replaced. The new system, BRASS by Budgeting Technology Inc. and now a product of American Management Systems Inc., is being used in the current year budget process. Like SAP, this new system is a client server-based system that provides on-line real-time access to the latest budgetary estimates for the current and upcoming year as well as drill down on the transactions that support those estimates. The budget system also allows for standard and ad hoc reporting as well as downloads. BRASS also has a module, Salary and Benefit Forecasting (SBFS), that is used to complete salary and benefit forecasts on a position-by-position basis.

BRASS is flexible and was easily adapted to use the organization, fund and object structures of SAP. As a result, budgetary estimates as well as actuals, stated on a budgetary basis from the SAP funds management module, are readily interfaced between the two systems. Similar structures and the use of interfaces with the payroll and personnel systems also have been established and used to support salary and benefit forecasting.

Previously the revenue and capital improvement programs budgetary processes had been handled through a series of shadow systems and reports. Significant progress is being made to fully integrate these processes into the new budget system as well. For example, this year, all estimates for the current year and five-year CIP were prepared in the BRASS system. Departmental revenue estimates also were submitted using BRASS.

In summary, the City's financial management functions well through: 1) citywide accessibility, 2) immediate access to current information and 3) information that is integrated throughout the system.

25. How does Phoenix measure the performance (in terms such as outputs, outcomes, or efficiency) of its financial management systems?

Three key measures of the City's overall financial management system performance are cited here and all represent independent validations. We believe and promote in our internal reports of organization-wide performance, that our bond rating are the most significant measure of overall financial management. Bond rating agencies review and consider all aspects of financial management and judge the organization with a rating that impacts that entity's cost of capital in the open market. The concept is - the better the financial management, the better the bond rating, the lower the costs of doing business, the more funding that is available for City services or to reduce taxation requirements. An example of the monthly City Manager's Executive Reports is included as Attachment FM-AE and this measure was selected as one Organization Indicator of performance.

The second area that we believe is a measure of overall results in financial management is the willingness of our voters to approve alternative spending limits. The Arizona Constitution establishes an inflation and population growth-based limit on municipal budgets and provides for voter-approved methods to alter those limits. All methods for altering the limit require voter approval. Our citizens have voted in favor of an alternative spending limit for nearly 20 years. The voters must approve the Home Rule alternative used by Phoenix every four years. In the most recent election, 80% of the voters said "yes."

The third area that is a broad measure of overall financial performance is the independent auditors' opinion. Phoenix receives unqualified opinions.

On a day-to-day and departmental management perspective, other measures of performance are used throughout the City. These measures include the classic input and output type counts as well as more results-oriented measures such as customer satisfaction and cycle times. Such measures have been established in conjunction with customers of our departments. The attached City Manager's Executive Report (Attachment FM-AE) includes those measures considered most important for use by City management and the City Council in evaluating the provision of City services for each City department. Of course, other measures are used and tracked throughout the City such as those reported in the annual budget document and those that are used within departments to monitor their services.

26. Is there anything else you think we should know about your Financial Management system? (For example, please describe any major problems or challenges that Phoenix has identified in the area of financial management. Also, tell us about any recent improvements or innovations in financial management that have occurred in Phoenix).

Of importance to note is that, in addition to the SAP modules we implemented on July 1, 1998, users were interested in the other functionality and modules available within SAP. Of particular interest to several operating departments was the Plant Maintenance module. SAP Plant Maintenance functionality includes support for managing emergency, preventive, and predictive maintenance of buildings, systems and fleets, a major activity component of these departments. It also provides for resource planning and cost planning and determination. Like the other SAP modules, a key feature is that Plant Maintenance is tightly integrated with the purchasing, inventory, and controlling modules.

Based on the expressed interest, the City began a pilot Plant Maintenance project in November 1998 with the Facilities Management division of the Public Works Department. Facilities Management is responsible for managing most City buildings and cooling systems. The pilot proved successful and Facilities Management will go live with Plant Maintenance on July 1, 1999. Given this pilot's success, we plan to make this functionality available to other departments over the next several years.

Along with the implementation of SAP, we also implemented a new labor distribution system to capture time worked for cost-accounting purposes. While the product has met a majority of the functional needs, we are looking to SAP to address additional requirements. To this end, included in the Plant Maintenance pilot is a test of the functionality of the SAP labor distribution module named Cross Application Time Sheets (CATS). Our goal is to provide an alternative labor distribution system for departments to utilize.

As noted in question 24, a number of increased measures were established to help address financial systems support issues as they surfaced. Specifically, during the implementation of SAP, a prototypical Project Team was created consisting of some members with a functional or operational orientation and some who were more technical in nature. The functional members of the team developed business processes and configured, tested, and documented the new system. The technical members established and managed the technical environment, configured the technical system, and assisted departments with the SAP desktop access (GUI). The Project Team became the system specialists having worked so closely with the system during development. After implementation, this expertise was used to field SAP user issues that surfaced through the help desk, user groups and other means.

User groups are active for most functional areas. Departments are encouraged to participate with any or all the user groups and have done so. Through the user groups, departments have direct access to the project team and play an active role in developing and/or refining the SAP system to meet the City's overall needs. They are invaluable to the success of the project and ongoing effort.

Transition management also played a very key role in the successful implementation of SAP. Transition management is, as the name implies, managing the change, or transition, from the old legacy system to the new SAP system. More to the point, this effort was designed to assist all City departments and users with that transition.

To initiate the effort, a transition team of Finance Department employees was created. The team reported directly to the Finance Director, who was also one of the project's executive sponsors. Each transition team member was assigned certain departments to work with and each department identified a management contact for the transition team member. The resulting organizational structure provided an indispensable two-way communication channel. The channel allowed the transition team to communicate news of project status, training schedules and other upcoming events to the departments, while the departments provided information and feedback to the team that was used to support project decisions. The transition team remains in place today and continues to facilitate communication as necessary.

Just before July 1, 1998, the SAP help desk was established for users. During the first six months of SAP operation, the project team and transition team met every morning with the help desk staff. The purpose of the morning briefings was to closely monitor the progress of call resolution and response time, and to receive reports on SAP system performance. The morning briefings still occur, but are now necessary only once a week.

An Intranet web site has been created for the new SAP system. Included are step-by-step procedures for all business processes, the new chart of accounts, and the conversion mapping from the legacy system's accounting structure to the new SAP accounting structure. We are in the process of expanding the web site to include the SAP security request form, other new master data request forms, a bulletin board with helpful tips and an area designed to help users with SAP reports.

Regarding the reports, with the additional data available to users at their workstations and the on-line real-time benefits of SAP, users are eager to fully use the reporting capabilities. The expansion of our SAP Intranet site will assist users in selecting reports based on their needs and provide instructions on how to generate the report, to include any required selections about the report. Also addressed will be how to use the on-line formatting tools so that reports can be tailored to the user's specifications. In addition to the Intranet site, the user groups disseminate reporting information regarding their functional areas.

We have made significant efforts to communicate with departments throughout the development, implementation and, now, the operations of the new SAP system. SAP is an enterprise-wide system and, as a result, several enterprise-wide communication initiatives were and are key to its development and ongoing success. Because of the citywide teamwork, the transition effort has resulted in enterprise use of a system that better supports financial management.

Phoenix faced a significant financial challenge in the 1990s. The 1991-92 and 1992-93 fiscal years were the most difficult in the City's recent history, with projected shortfalls of $20 and $25 million respectively. These challenges were met by cutting costs and minimizing the impact on the citizens of Phoenix. Administrative overhead was reduced by $21 million, the City's workforce was reduced by 470 jobs, and City services were protected to the fullest extent possible. The pension and self-insurance funds continued to be fully funded. Bond rating agencies continued to show their confidence in the City's ability to manage its financial affairs during the most difficult of economic times. The City also continued to be recognized nationally and internationally for sound business practices.

The 1988 bond program was also impacted. Our Citizens Bond Committee had sized the 1988 bond program based upon a 10% assumed annual growth in assessed value. In 1991, assessed values grew only 0.3% and the values declined in 1992 and 1993 leaving the program financially infeasible. In 1990 and 1993, the Bond Committee reprogrammed, eventually stretching the program out through 2002 including reprioritization of planned projects and identifying new urgent projects that were substituted for projects that become lower priorities.

These actions have positioned the City well to deal with the continuing challenges of the future. These challenges include the potential for reduced federal funding, increased community needs in many areas, and the cyclical nature of the local and state economies.

Thank you for your valuable assistance in providing this information.

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